SOUTH CAROLINA
ANALYSIS OF IMPEDIMENTS TO FAIR HOUSING

AMENDMENT REGARDING PREDATORY LENDING

SOUTH CAROLINA DEPARTMENT OF COMMERCE

UPDATE TO THE ANALYSIS OF IMPEDIMENTS TO FAIR HOUSING

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SOUTH CAROLINA ANALYSIS OF IMPEDIMENTS TO FAIR HOUSING
PROPOSED AMENDMENT ON PREDATORY LENDING

PREDATORY LENDING

"Predatory lending" is a general label for a wide variety of practices and loan terms that are harmful to the borrower. Predatory loan practices and terms run the gamut of legal and fraudulent activities, making it difficult for the consumer finance industry, regulators and advocates to agree on a definition of predatory lending. Because abusive lenders can be creative about devising new predatory tactics, it is even difficult to catalog predatory lending practices. The complexity of the issue also presents a challenge to consumers trying to avoid the excessive expense and greater risk of foreclosure or bankruptcy associated with predatory lending.

Predatory lending is concentrated in the subprime lending market that rapidly expanded in the1990s (from 104,000 loans in 1993 to almost a million in 1998 (*Unequal Burden*, 2000).
The subprime market offers loans at premium prices to borrowers who represent a higher credit risk than borrowers in the prime market because they have poor credit histories or high debt relative to income. Some characteristics of the subprime market create opportunities for abusive lending practices that disproportionately affect low-income minority and elderly populations. Subprime mortgages may be a first mortgage (to purchase or refinance a home), a second mortgage or a home equity line of credit. Most often the mortgage is for debt consolidation or general consumer credit but they are also used for home improvement. In addition to higher risk, subprime mortgages generally have lower loan amounts, higher origination costs and faster repayments. (HUD-Treasury, 2000).

To distinguish predatory loans from risk-based subprime lending, analysts recommend reviewing both the terms of the loan and the practices of the lender. Predatory loans are more likely to include excessive fees, prepayment penalties, large balloon payments, negative amortization or high cost credit insurance. Predatory lending practices can include high-pressure tactics, lying, misrepresentation or obscuring of loan terms to the borrower, and fraud (e.g. distorting borrower information on the application). The lenders also may target particular communities or classes of people (reverse redlining). (Goldstein, 1999).

Loan terms that are considered predatory

- High interest rates that do not correlate with risk. Subprime loans carry higher interest rates than conventional loans but are considered predatory when they exceed the cost of risk associated with the loan or if the borrower was directed to a high risk loan when they would have qualified for a lower rates. Freddie Mac estimates that between 10% and 35% of borrowers who obtained mortgages from subprime lenders could have qualified for a conventional loan (Freddie Mac, 1997).
- Yield-spread premiums. Yield spread premiums are fees paid to mortgage brokers in exchange for placing a borrower in a higher interest rate mortgage than the lender established for the loan. The broker receives the fee and lender receives the higher interest rate over the life of the loan (HUD-Treasury, 2000).
- Excessive fees (fees exceeding 3-5% of the loan amount). While borrowers of conventional loans typically pay about 1% of the loan amount in fees, research on predatory lending is replete with stories of people who were charged as many as 10 points for a loan.
- Single premium credit insurance. Credit insurance is purchased by the borrower to protect loan repayment should the borrower become disabled or die. When the lender requires the borrower to pay for the credit insurance upfront by financing the total cost of the premium (a single premium) into the loan, the borrower pays interest on the premium

over the life of the loan (e.g. 15 –30 years) typically paying for the insurance long after the period of insurance coverage has expired (e.g. 5 years). In the worst cases, financing the insurance even hides the fact that the borrower is purchasing insurance. (Stein 2001)

- Loan flipping. This refers to the practice of repeatedly refinancing subprime loans and results in the loss of equity from repeatedly incurred fees.
- “Traps.” A number of abusive practices have been labeled “traps” because they can force the borrower to refinance or go into foreclosure. (Goldstein, 1999) The following practices are common “traps.”
  - Negative amortization or the structuring of the loan so that payments do not reduce interest and the principal amount of the loan increases.
  - Mandatory arbitration. Binding arbitration clauses in loan contracts limit the rights of the borrower (e.g. preventing participation in class action suits or delaying temporary or emergency relief that a court can provide and may be important when resolving loan disputes) and are especially abusive when the borrower is compelled to agree to arbitration clauses without knowledge of these rights or when the borrower is required to help pay for the arbitration. (HUD-Treasury, 2000).
  - Prepayment penalties. Prepayment penalties are fees paid to lenders by borrowers who wish to pay the loan before the end of the loan term. These high fees (e.g. 5% of the loan) prevent borrowers who may need temporary credit from moving from high cost loans to conventional loans. (HUD-Treasury, 2000)
  - Balloon payments. Large balloon payments (as much as 85% of the loan) at the end of the loan period typically compel the borrower to refinance. Balloon

payments are especially harmful when due a short time (e.g. five years) from closing.

Lender practices that are considered predatory

Some predatory lenders engage in “reverse redlining” or aggressive targeting of high cost loans to classes of people, particularly elderly, low-income minorities or women who are financially vulnerable. Low income and African American borrowers account for a larger share of the subprime refinance market than the general mortgage market. The female share of subprime loans is also higher than that of other mortgages and subprime borrowers also tend to be older and less educated than prime borrowers. To the extent that these populations are financially vulnerable, it is not surprising that they must seek higher risk loans. But research and testimony suggest that risk does not fully account for their share of the subprime market. An analysis of Home Mortgage Disclosure Act (HMDA) data documents significant racial disparities in subprime lending. Lower income African Americans receive 2.4 times as many subprime loans as lower income whites while upper income African Americans receive 3.0 times the number the of subprime loans as do whites of comparable incomes. (2000, Bradford). Similarly, low income Hispanics receive 1.4 times as many subprime loans as low income whites and upper income Hispanics receive 2.2 times the number of subprime loans as whites of similar income. In U.S. Department of Housing and Urban Development (HUD)-Department of Treasury sponsored hearings in five metro areas in the country people testified that these groups had been steered to high rate/high cost loans based on race, economic status or gender. Examples included higher interest rate loans charged to black females than white males (U.S. v. Delta Funding Corporation); targeting of “house rich but income poor” elderly; targeting low income African American neighborhoods and other discriminatory practices (HUD-Treasury, 2000).

Sometimes the targeting involves home improvement scams in which a homeowner is sold a home repair and a mortgage refinance package (including the cost of the cost of the repair). The repairs may never be completed or may be poorly done but the homeowner ends up with an expensively refinanced mortgage to pay for it.

PREDATORY LENDING AS A FAIR HOUSING ISSUE

The Fair Housing Act requires equal treatment in terms and conditions of housing opportunities and credit regardless of race, religion, color, national origin, family status, or disability. The Equal Credit Opportunity Act requires equal treatment in loan terms and availability of credit for all of these categories as well as age, sex and marital status. When lenders impose fees, terms or conditions on credit that are different for some people based on their race, sex, age or other categories noted above they violate fair housing laws. Other predatory practices noted above also are discriminatory including reverse redlining, or targeting people (by age, race or gender) for these disadvantageous loans and steering people in these protected classes to more expensive loans than their credit worthiness requires or than what other people with similar credit receive. Hiding or failing to disclose loan terms or conditions also violates fair housing laws.

THE IMPACT OF PREDATORY LENDING

There is no good data on predatory lending for several reasons. The sheer variety of predatory activities makes them difficult to track. Many activities are not regulated and even those that are fall under the purview of different federal and state monitoring agencies. Short of a thorough examination of all consumer and mortgage loans, analysts have relied on available data to suggest the extent of the problem. These data have included Home Mortgage Disclosure Act data, foreclosure data, consumer complaints, data generated in the service of lawsuits, and investigations by consumer and community advocates. The data available for South Carolina are very scarce.

South Carolina's relatively high participation in the sub-prime market makes it vulnerable to predatory practices. Twenty percent of South Carolinians participate in the subprime market, almost twice the national rate. Similarly, at almost 42%, the number of African Americans turning to the subprime market in South Carolina greatly exceeds the average rate of 18.6% for African Americans in the US. The number of low-income people turning to subprime lenders in South Carolina is 33.8% compared to 13.2% for the nation. Data are more available regarding subprime market participation in metro areas of the state than for rural areas. The Center for Community Change examined the conventional refinance loans for the 2000 HMDA data and determined that all but one (Myrtle Beach) of the Metropolitan Statistical Area (MSA) in South Carolina have subprime lending levels above the national norm of 25.31%. These MSAs include Sumter, Florence, Charlotte-Gastonia, Rock Hill, Columbia, Charleston-North Charleston, Greenville-Spartanburg-Anderson, August-Aiken . (Bradford, 2002)

The study also calculated the percentage of subprime loans made to African-American borrowers in MSAs. The three MSAs in South Carolina with higher rates than the national average of 49.28% include Charleston-North Charleston, Columbia and Florence (55.94%). (Bradford, 2002)

There have been few attempts to calculate the actual cost of specific predatory practices. The Coalition for Responsible Lending estimated the annual cost to U.S. households of predatory lending from two practices: equity stripping (charging high fees, financing credit insurance or including prepayment penalties) and rate risk disparities (charging a higher rate of interest than credit histories would justify). Using different sources of data to estimate the cost from these different activities, the study suggests that annually American households pay $9.1 billion in lost homeowner equity, penalties and excess interest paid. Based on South Carolina's 2000 share of the U.S loan volume, the estimated cost in South Carolina is $107 million. (Stein, 2001)

Because foreclosures are an outcome of some predatory practices, some analysts examine foreclosure rates to understand the cost of predatory lending. In January 2003, the **Charlotte Observer** reported foreclosure rates in South Carolina hit a new high each of the first three quarters of 2002. The Mortgage Bankers Association of America's survey revealed that creditors were seeking to reclaim more than 9,000 S.C. homes in the quarter that ended Sept. 30. New foreclosures were started on subprime loans seven to nine times as often as on conventional prime mortgages in the Carolinas in the third quarter and the group noted its survey of subprime loans was not comprehensive. Research on foreclosures in large urban centers across the country indicate that subprime loans account for a greater rate of foreclosures than of originations and that the foreclosures occur sooner with subprime loans than foreclosures of other lenders. The practice of targeting particular communities or neighborhoods for these abusive loans potentially extends the cost of foreclosure beyond individuals to neighborhoods if the foreclosures are concentrated.

Foreclosure in SC

Mr. "Poe" owns a home in a rural South Carolina County. He and his wife owed a mortgage with a balance of around $30,000 secured by the home. Mr. Poe's wife died and his health declined. A sales person for a mortgage company began to visit him at home to attempt to convince him to refinance his mortgage. In the spring of 2000, Mr. Poe was admitted to the hospital for treatment of heart disease. The sales person continued to visit him. Mr. Poe told her that he did not want to borrow more money. The sales person persisted and finally got Mr. Poe to sign papers for the refinancing. Mr. Poe talked to his son and decided to cancel the loan the next day. He sent a written notice of cancellation to the lender, but there was no response and he began to receive billings for the mortgage payments.

Mr. Poe's original mortgage had ten years of payments left at a fixed rate of 10.05% with a monthly payment of $371. After the refinancing Mr. Poe owed a principal balance of $38,400 at an APR of 12.24%, and a monthly payment of $402. This payment amount did not fully amortize the loan, and the note called for a balloon payment of $11, 650 at the end of fifteen years. Due to his poor health and medical expenses, Mr. Poe did not make the mortgage payments and the eventual holder of the note filed a foreclosure action. A foreclosure judgment was entered before Mr. Poe sought legal assistance. A judicial sale has been delayed due to problems with the title to the property.

Case from a legal services office in South Carolina. .

Other evidence of the problem

Several thousand South Carolinians participated in a class action suit against a large finance company alleging the company broke state laws by using unfair and deceptive practices. **The State** newspaper reported that $5 million of the $484 million settlement negotiated with the company would be returned to South Carolinians who received loans since 1999. The South Carolina Attorney General's office reports it is finalizing the data on who will be compensated and at what level.

In March of 2002, the South Carolina Department of Consumer Affairs announced a consent settlement with a corporation regarding a civil action suit alleging illegal loan brokering. Department of Consumers Affairs had received complaints that the corporation had misrepresented services they offered when they offered applications for credit cards that were in fact secured catalogue sales cards. The corporation also required consumers to pay a high fee to procure the card.

Predatory Lending "Traps"

A new client was accepted recently because she appears to be a victim of predatory lending. Ms. "Doe," who was diagnosed several years ago with paranoid schizophrenia, owned her own mobile home. She receives disability payments because of her mental illness, and owning her home is especially important with her limited income.

Some time ago, Ms. Doe's car broke down and she borrowed money to have it fixed. She borrowed the money from a small, local lender who required a lien against her home. Ms. Doe has had trouble paying the loan back, and has also borrowed money from other local lenders, none of them banks.

Ms. Doe wants to file for bankruptcy to save her home. After reviewing the loans, however, she may also have predatory lending claims against these lenders. One loan agreement included premiums for unemployment insurance despite the fact that she was unemployed and on disability when she signed for the loan. Another loan has been renewed (flipped) five times over the last two years. She is hunting for more of her loan contracts, which may contain other predatory lending practices.

Case from a legal services office in South Carolina.

Actions taken to date within the State

South Carolina Department of Consumer Affairs

The South Carolina Department of Consumer Affairs reported in a newsletter dated Fall 2001 that the number of complaints they received regarding predatory lending had increased. The office continues to take action against companies that violate existing lending statutes. The

Department also has developed written and website materials to educate consumers about predatory practices.

The Attorney General of South Carolina

Attorney General Henry McMaster has expressed support in hearings and guest editorials for legislation that addresses predatory practices such as loan flipping, high costs or fees.

South Carolina State Housing and Development Authority

The South Carolina State Housing and Development Authority Homeownership Program reports anecdotal evidence of predatory lenders targeting homeowners in their programs. They have not analyzed their foreclosure data for evidence that predatory lending has resulted in their homeowners losing their homes. All individuals participating in their programs are required to receive homeowner training before they receive their loans and the training curricula provided through local lenders has been expanded to educate participants about predatory lending practices.

The South Carolina Human Affairs Commission

The Human Affairs Commission reports no increase in fair housing complaints with predatory lending as the issue. They have not developed new programs in response to predatory lending practices but continue to address predatory lending as a fair housing issue in their work in the community.

The South Carolina General Assembly

Both the South Carolina House and Senate have introduced legislation to curb predatory lending practices. As of April 2003, the legislation was in a conference committee. The Senate bill addresses most of the practices itemized in the above description of predatory practices including excessive fees, single premium credit insurance, loan flipping, traps, prepayment penalties and large balloon payments.

The Affordable Housing Coalition of South Carolina

In 2002, the Affordable Housing Coalition of South Carolina sponsored four educational workshops on predatory lending in Columbia, Beaufort, Greenville, and Florence. Participation ranged from 25-50 people. Panelists included representatives from Appleseed Legal Justice Center, the South Carolina Department of Consumer Affairs, Self-Help Credit Union (NC) and the AARP.

ACTION PLAN TO ADDRESS THE IMPEDIMENTS

1. Impediment: There are limited data available on the extent and characteristics of predatory lending in South Carolina.
2. Impediment: The general public lacks information about predatory lending and the complexity of the issue and the number of overseeing agencies may make it difficult for individuals to access information or file complaints.
3. Impediment: State resources for regulation enforcement and education are limited.

Action Goal: Distribute this Amendment to the Analysis of Impediments in order to foster discussion and cooperation among agencies responsible for eliminating predatory practices, such as consumer education, consumer law enforcement, and affordable housing agencies.

Action Goal: Pending legislation in South Carolina on predatory lending, develop a plan to respond to the issue by convening agencies with consumer law enforcement, consumer education and affordable housing responsibilities to review current practices toward predatory lending prevention and enforcement.

Action Goal: Increase knowledge of predatory practices among relevant agencies and consumers in order to enhance their capacity to identify, prevent and respond to predatory practices. For example, housing agencies could investigate ways to structure or write loans with protections that prevent or alert consumers to risks of refinancing. Agencies could sponsor periodic in-house training to keep abreast of current forms of predatory practices in South Carolina. Consumer education would complement and facilitate compliance with state predatory lending legislation.

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